



# **INSTITUTIONAL BOTTLENECKS AND VIET NAM'S PROSPECTS FOR GROWTH AND DEVELOPMENT**

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# **POLICY BRIEF**

## **Institutional Bottlenecks and Viet Nam's Prospects for Growth and Development**

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### **ABSTRACT**

The quality of public institutions is often seen as a critical factor in economic growth and development. While institutions in high-income countries tend to perform better than in low and middle-income countries, the evidence fails to show a consistent relationship between institutional quality and economic growth. This suggests that we need to approach the analysis of institutions with caution. Since institutions are shaped in fundamental ways by the historical, cultural, and social context in which they arise, generalizations based on imported models of governance often miss the mark. Viet Nam is an example of a country that has achieved rapid economic growth with public institutions that do not conform to international norms. Like most Southeast Asian countries, Viet Nam's public institutions are fragmented, with overlapping jurisdictions and weak coordination. Viet Nam's public sector is commercialized because of the unique characteristics of the country's transition from central planning to the market. Fragmentation and commercialization complicate efforts to cope with the country's emerging economic challenges. The experience from China suggests that even within decentralized administrative structures strengthening the public sector personnel system could make a vital contribution to reducing the negative effects of fragmented authority.

## Introduction

The quality of economic institutions is widely seen as a critical factor in economic development. Daron Acemoglu and James Robinson begin their celebrated book on the subject with a comparison of two cities named Nogales—a rich one on the American side of the border, and a poor one in Mexico. These cities are said to be identical in terms of culture, geography and demography, but differ mainly in the quality of their economic and political institutions. According to the authors, these differences “create very disparate incentives for the inhabitants of the two Nogaleses,” and they are “the main reason for the differences in economic prosperity on the two sides of the border” (Acemoglu and Robinson 2013, 9).

Institutions offer a disarmingly simple and intuitively appealing explanation for differences in living standards. Poor countries grow faster when they reduce corruption, protect property rights, enforce laws and regulations in a fair and transparent manner and hold competitive elections. Scholars and development agencies have spent considerable time and money collecting data on the quality of institutions and analyzing the relationship between governance and growth.

This policy brief considers institutional bottlenecks to growth in Viet Nam. The main conclusion is that institutions do matter, but often in unexpected ways. Institutions that are associated with sustained high rates of investment and export growth—the two factors most closely associated with economic growth—do not always conform to textbook models (Khan 2007). The relationship between institutional change and economic growth is complicated and shaped fundamentally by the historical, cultural, and social context. Disentangling the direction of causality in the relationship incomes and institutional quality is another source of confusion: it is difficult to know definitively if the effect of higher incomes on institutions is more or less important than the effect of institutional change on economic growth.

These complications do not diminish the importance of good governance. We all want to live in societies that are free from corruption, where people are rewarded for their talents and effort rather than their connections, where laws and regulations serve the public interest and where their enforcement is impartial and consistent. These characteristics of well-governed societies are desirable for their own sake, regardless of whether they are associated with rapid economic growth.

The first part of this policy brief looks at the relationship between good institutions as conventionally defined, and economic performance, taking as a starting point a recent World Bank report. The second section examines the Vietnamese case in more detail, focusing on the long-term problems of fragmentation of authority and the commercialization of state agencies. A discussion of the policy implications of the analysis follows, and the final section concludes.

## A Middle-Income Institutional Trap?

In a recent report, the World Bank argues that Viet Nam will fall into a “middle income institutional trap” if it fails to improve the quality of its economic institutions (World Bank 2021, 81). Using the Worldwide Governance Indicators (WGI) as a benchmark, the report plots governance rankings against per capita Gross National Income (GNI) for selected countries. The graphs reveal a linear relationship between the quality of institutions measured as WGI rankings and per capita income. Viet Nam falls in the middle of the WGI pack, and the country’s income per person is still relatively low. The implication is that hopes of moving up the income ladder hinge crucially on improving the quality of economic governance.

The claim that growth, poverty reduction, and prosperity are causally related to governance indicators like rule of law, absence of corruption, democracy and political stability is made frequently in the development economics literature (Acemoglu, Johnson, and Robinson 2004; North 1989). The argument is intuitively appealing because performance on governance surveys is closely associated with income levels. If rich countries are governed better, did the superior quality of their institutions cause economic growth in some way?

The first problem that we confront in attempting to answer this question is that measuring the quality of institutions not a simple matter. The WGI strategy is to combine a range of indicators across six dimensions of governance (voice and accountability, regulatory quality, political stability and absence of violence/terrorism, rule of law, government effectiveness and control of corruption) to arrive at an index for each dimension and country rankings based on the indices. The indicators include outcome measures like school enrolments and access to infrastructure, and subjective measures from surveys of businesses and citizens. No theoretical justification is offered for the choice of indicators or the aggregation technique, so it isn’t clear what the scores mean or how to interpret them. Implicit in the methodology is the assumption that “good institutions” look the same wherever we find them, regardless of the specific historical, cultural political context in which they arise (Andrews, Hay, and Myers 2010).

Beyond measurement issues, there is the critical question of causality. If prosperity gives rise to good institutions rather than the other way round, the policy prescriptions suggested by simple correlations of WGI and income need to be revisited. Is Nogales, Mexico poor because it has dysfunctional institutions, or are its institutions dysfunctional because Mexico is poor? Political philosophers since Aristotle have pointed out that societies with large middle classes are more stable and are better governed than

polarized societies.<sup>1</sup> Richer countries record higher levels of educational attainment, are more economically secure, and suffer less political violence and factionalism than poor countries. One could also make the argument that good institutions do not come cheap: poor countries lack the resources needed to sustain a well-functioning legal system and regulatory agencies staffed by highly trained specialists, not to mention high-quality schools, hospitals, and public infrastructure.

Nor does the experience of other successful Asian countries support the hypothesis that good institutions are prior to or somehow cause growth. In the report mentioned above, the World Bank argues that the Republic of Korea achieved rapid growth because of its good institutions. But quality of Korea's institutions during the period of rapid economic growth from 1963 to 1996, was uneven to say the least, with widespread evidence of corruption and repression, and episodes of extreme political violence and instability. At the very least, China and India's economic institutions do not conform to the Western ideal of liberal democracy, a minimal state, strong protection for property rights and the rule of law.

The relationship between governance and growth is complicated. To underscore the point, we divide the 174 countries in the WGI database into two groups: low and lower middle-income countries and high and upper-middle income countries. Then we separate these groups into low, middle, and high achievers in each governance category. The results are interesting. For both lower and higher income countries, higher WGI scores for voice and accountability are associated with *slower* economic growth over the period 2000-2020 (Figure 1). The same is true for rule of law (Figure 2) and regulatory quality (Figure 3). The relationship between growth and control of corruption is negative for low and lower-middle income countries, but for upper-middle- and high-income countries high control of corruption is associated with slightly faster growth over the period (Figure 4). The only exception to the general pattern is for the state effectiveness indicator, where higher scores are associated with more rapid growth among upper-middle and high-income countries (Figure 5). The relationship between state effectiveness and growth probably reflects characteristics of the sub-indicators in this category, which include outcome measures like access to education, water and sanitation and health care.

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<sup>1</sup> "Thus it is manifest that the best political community is formed by citizens of the middle class, and that those states are likely to be well-administered in which the middle class is large, and stronger if possible than both the other classes, or at any rate than either singly; for the addition of the middle class turns the scale, and prevents either of the extremes from being dominant (Aristotle 2016, 111).

Figure 1. Average annual economic growth by income group and WGI Voice and Accountability Scores, 2000-2020

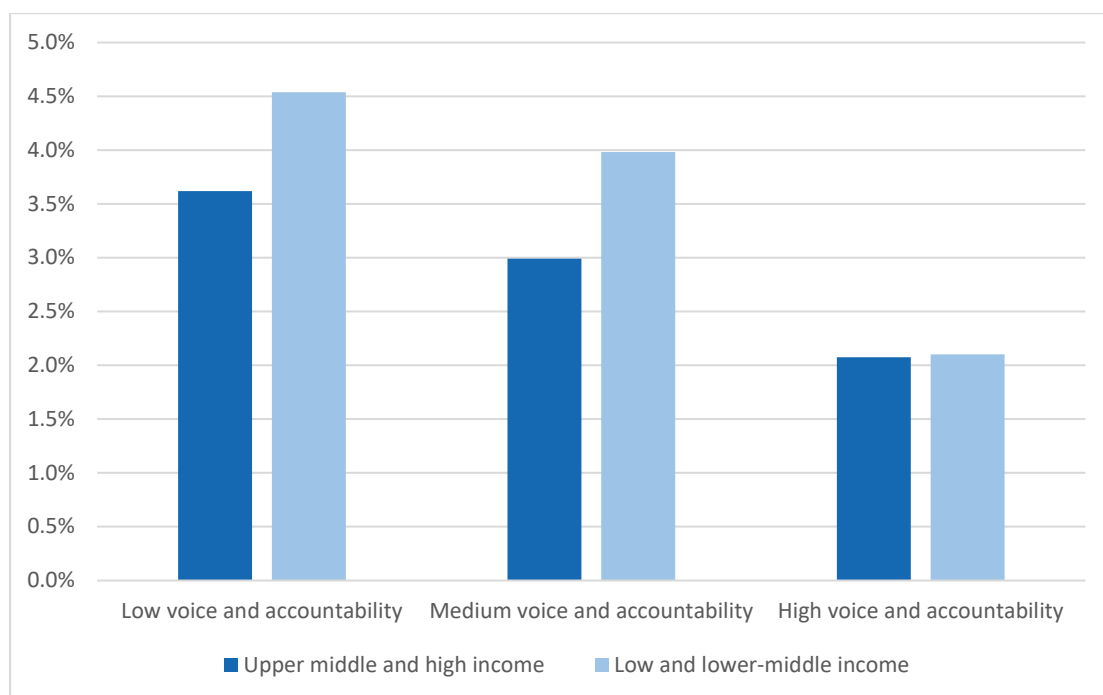


Figure 2. Average annual economic growth by income group and WGI Rule of Law Scores, 2000-2020

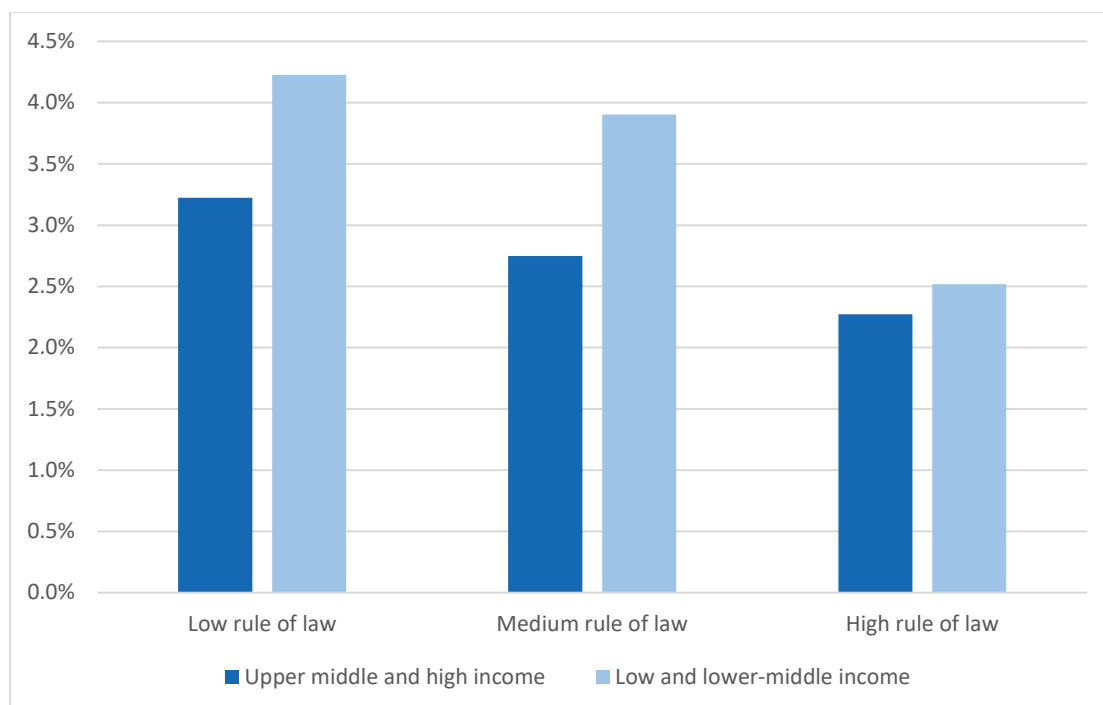


Figure 3. Average annual economic growth by income group and WGI Regulatory Quality Scores, 2000-2020

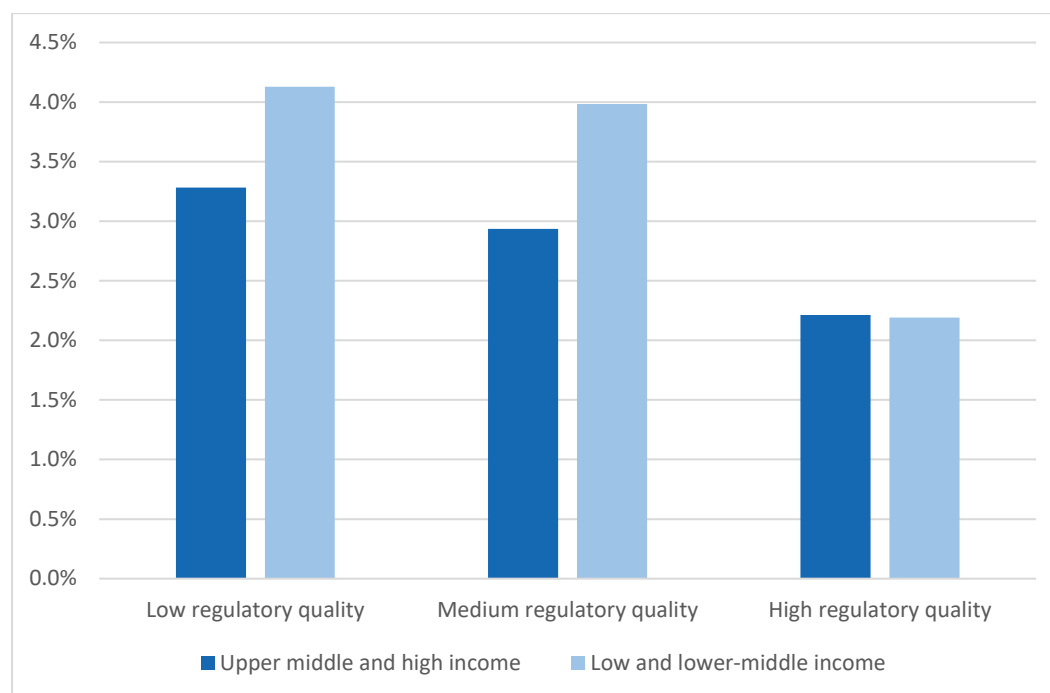


Figure 4. Average annual economic growth by income group and WGI Control of Corruption Scores, 2000-2020

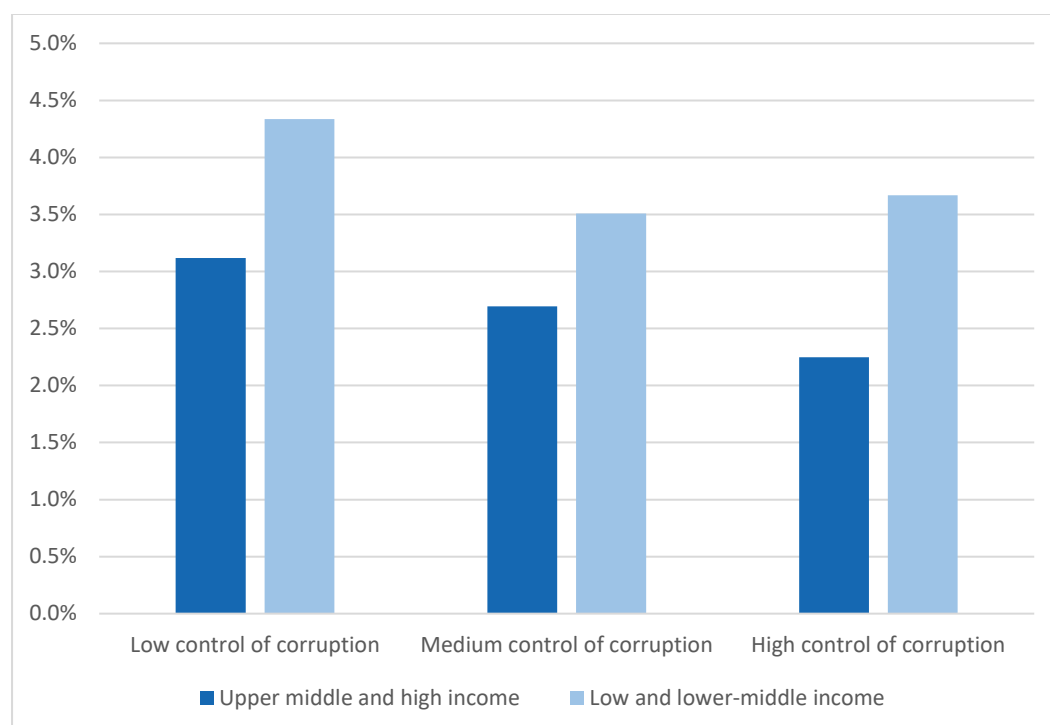
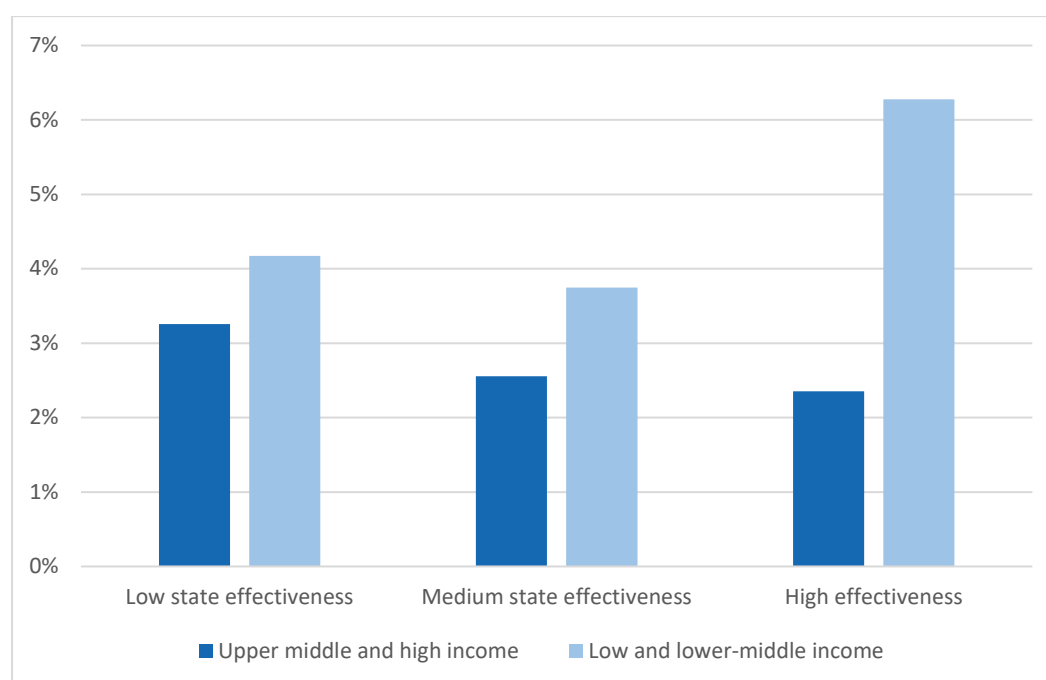


Figure 5. Average annual economic growth by income group and WGI State Effectiveness Scores, 2000-2020



The point is not that good institutions (as defined by WGI) are bad for growth: the differences between the groups are too small, and the variances too large, to warrant such a conclusion. Economic institutions do matter, but understanding which institutions matter in which situations, and how to improve institutional quality and performance, requires an appreciation of the economic, political, cultural and historical context of each country, and an analysis of how these unique conditions create impediments to and opportunities for growth. Institutional isomorphism, or the idea that economic forces will compel countries to adopt identical economic institutions, is not supported by the empirical evidence.

In the following sections, we will explore some of the institutional constraints facing Viet Nam, and argue that generic governance indicators largely miss the point. The institutional challenges facing Viet Nam are a product of the country's unique history and distinctive trajectory of reform. Viet Nam's public institutions are fragmented, meaning that authority is divided vertically and horizontally, and highly commercialized. These characteristics of Viet Nam's institutions will make responding to major challenges like climate change adaptation and mitigation more difficult because they reduce the coherence and hence the impact of government policy.



## Viet Nam: A Fragmented, Commercialized State

In some respects, Viet Nam's public institutions are among the most effective in the region (Beeson and Pham 2012). Unlike Thailand, Indonesia and the Philippines, Viet Nam has avoided factionalism and political paralysis; the government's response to the Covid-19 crisis was rapid and decisive; and judging from outcome indicators like maternal mortality, literacy and electrification, Vietnam has demonstrated a capacity to set clear development targets and implement programs to achieve them quickly.

Yet there are also many examples of public institutions functioning poorly. Interagency and interprovincial coordination is weak, and higher-level authorities struggle to enforce rules and direct action at the lower levels of the bureaucracy. Decision making power divided horizontally across agencies and vertically between the center and provinces; access to public sector jobs is widely considered to be based on personal connections rather than merit; and the border between the public and private interests is blurred. Consistent application of the rules, the hallmark of modern bureaucracy, has given way to a system that increasingly resembles the imperial pattern of concentric circles of influence.

This combination of bureaucratic capacity and institutional dysfunction is a product of the country's unique history and engagement with imported models of governance. Alexander Woodside's studies of 19<sup>th</sup> century neo-Confucianism in Viet Nam have shown that the ideal of a centralized, hierarchical, and meritocratic state has continually run up against the reality of distinctly Southeast Asian power structures. Under the *ancien régime*, the center's efforts to achieve political control was circumscribed by the capacity of local officials to withhold information, creating space for bargaining between localities and the court. Village life, which centered on lineage groups and mutual aid societies, provided few access points of external leverage. The absence of strong indigenous commercial classes was another obstacle to elite cohesion: even as late as 1931 the population of Saigon was just 120,000, 34,000 of whom were ethnic Chinese (Alexander Woodside 1988, 147). Viet Nam's polity for most of its history was locally oriented, atomized, and imperfectly integrated.

French imperialism was uninterested in state building. In 1937, the French ruled 17 million Vietnamese with slightly less than three thousand administrative personnel and 11,000 French troops; compare this to the 246,000-strong Japanese civil service in Korea governing a country of 21 million (Cumings 2005, 217). The French colonial government centralized what was important to it, for example customs and security, but left the rest of the administration to atrophy. This was evident in its approach to education: only two percent of children received a primary education in Viet Nam in the 1930s, compared to 70 percent in Taiwan (Cumings 2004, 294).

Viet Nam achieved independence and reunification after four decades of war. To paraphrase Charles Tilly, war made the modern Vietnamese state, and the Vietnamese

state made war. But state-building and war-making were built on localism rather than uprooting it, especially under the pressure of American bombing of the North from 1965 (Beresford and McFarlane 1995, 54). The traditional village elite was replaced by party cadres, and conscription brought millions of rural people into national institution for the first time. Wartime mobilization was achieved, but the mechanisms deployed proved ineffective in peacetime. A failed attempt to implement Soviet-style central planning forced economic activity into informal channels and created bottom-up pressure for reform. Farmers, state enterprise managers and anyone with access to Soviet or Chinese aid traded outside of the plan; local authorities tolerated smuggling to obtain essential supplies and in exchange for illegal levies, some of which were channeled into local government coffers (Fforde and Paine 1987). Tolerance for “fence-breaking” activities allowed underground markets for goods to flourish.

Over time, the state itself was marketized (Cheshier 2010; Fforde 2007). Commercial interests coalesced within state enterprises, central ministries, and the local party-state. The number of state enterprises mushroomed from 3,000 to 12,000 in the four years after 1985, triggering a credit-fueled boom and hyperinflation. In reaction, the government imposed an orthodox stabilization program and a cull of nearly half of state-owned enterprises. The macroeconomic rules of the game were re-established, but the era of central planning was over. Restrictions on domestic markets, international trade and foreign investment were wound down; household and small enterprises flourished, creating new income-earning opportunities for state and non-state actors. The vacuum left by the absence of an established commercial class was filled by state enterprises, central and provincial agencies and government personnel working on their own account or linked to businesses and individuals outside of the state. In Jonathan London’s words, “what occurred was the development of a business class *within* the state” (London 2009, 385).

The number of SOEs and their share of economic output remained roughly constant until end of the 1990s, when the East Asian financial crisis triggered a new round of SOE “equitization”. Equitization did not challenge the commercialized state but did force a change in strategy: no other groups had the capital, knowledge, and connections to profit from the joint-stock companies created by equitization, leaving SOE managers and provincial officials to channel public assets, particularly land, into quasi-private companies under their control. In Gainsborough’s formulation, equitization, far from signaling a retreat of government from the economic sphere, was a mechanism of “state advance” (Gainsborough 2009).

SOE restructuring did not encourage the development of a dynamic private sector because the state has thus far been unable to prevent state (and equitized) companies from leveraging their position to capture domestic markets and engage in speculative activities. The absence of an external regulator, strict accounting standards, independent audits, independent board members and clear and monitorable performance criteria has allowed self-dealing and other rent-seeking behavior to continue unabated (Vu 2014).

Spectacular corruption scandals in 2010 and 2012 revealed an absence of controls on management, and an inability or unwillingness of government to take decisive action to correct the situation (Hiep 2013). The rise of quasi-private conglomerates—large business groups that are nominally private but linked to the state through family and other relationships—are another expression of state commercialization (Cheshier and Pincus 2010). These groups play a pivotal role in domestic property and financial markets, enjoy preferential access to land, approvals and finance like SOEs, but unlike state firms are not called upon to finance the government or support other public objectives. The quasi-private conglomerates are almost exclusively focused on speculative activities and the domestic markets and have shown no interest in competing in export markets.

An important consequence of state commercialization has been the slow formation of genuinely private commercial groups that can hold the government to account. Nearly forty years after the launch of the *doi moi* reforms, the private sector consists almost entirely of micro and small-scale enterprises. While national firms in the fish and shellfish industries have succeeded in export markets and developed strong technological and managerial capacities, there are few similar examples in manufacturing, which remains dominated by foreign firms. The absence of powerful, genuinely independent commercial groups reduces political pressure for a rules-based system of economic governance.

### *“Fragmented Authoritarianism”*

State commercialization has proceeded in tandem with fragmentation of political authority, processes that are related and mutually reinforcing. The collapse of the planned economy shifted economic power—at least in theory—from the central state to enterprises, local authorities, and households. The relaxation of controls meant that the central authorities needed new instruments—laws, regulations, and oversight mechanisms—to align decentralized decision-making to the government’s aims and objectives. Crucially, the central authorities needed to back up its rules with the political power to enforce its will on profit-seeking entities within the central and local state apparatus.

The tension between the ideal of a centralized state and the reality of local power is arguably greater in Viet Nam than in any other country in Southeast Asia. Pre-colonial Viet Nam imported its core political concepts from China, but the structural characteristics of the two countries were very different. In China, wealthy landlord and merchant classes financed the central state and backed it politically. Vietnamese society was overwhelmingly rural and its elite was small and atomized. Local political structures were autonomous from, and not organically linked to the central state (A. Woodside 1989). The state’s control over local officials was more symbolic than real, and to get things done central officials needed to build alliances with local power brokers (Marr 2004, 48).

The attempt to adopt Soviet central planning in a traditional, rural society dominated by small producers was analogous to the earlier importation of Chinese political structures. In both cases, a grand, imported vision ran up against the reality of an atomized structures and weak central institutions. As we have seen, resistance to central planning emerged

from the bottom up, and the transition to the market reinforced the power of local authorities. Central government grew increasingly dependent on provinces for contributions to the treasury, and the remit of local government increased as it inherited responsibility for basic services like housing and healthcare that had previously been the responsibility of state enterprises. Constraints on central budget funding compelled provinces to rely on alternative sources of revenue, notably creating and supporting local state enterprises to raise funds and implement infrastructure projects (Vu 2014, 18). Foreign direct investment and international trade were no longer a monopoly of the central state, and the concentration of foreign firms in just a few locations strengthened the hand of these provinces. Decentralization to the province level was acknowledged in the 1996 Law on the State Budget (revised in 2002 and 2015), which gave provinces greater authority over how centrally allocated funds were spent, and the right to retain revenues after meeting centrally determined—but negotiated—targets. In practice, resource sharing between center and locality, including the allocation of investment funds, depends heavily on political and kinship relationships and other forms of personal loyalty (London 2009, 386).

The ambiguous financial relationships between the center and the localities are reflected in administrative structures, in which local agencies operate under “dual accountability” to central government ministries and the provincial people’s committees. In fact neither the ministries nor local authorities can impose their will on subsidiary agencies, leaving room for negotiation horizontally across agencies and vertically within sectoral ministries and their local representatives (Painter 2003, 266). The growing power of local authorities was also apparent in the composition of the Central Committee, which increased from 101 members following the 1976 congress to 170 in 1996. Provincial leaders accounted for a significant proportion of new members, and now make up the largest bloc within the body. The 12<sup>th</sup> Central Committee selected in 2016 consisted of 187 members, 67 of which were provincial officials. This gave local leaders considerable influence over the selection of top leaders and other key decisions (Vu 2014, 32).

The situation in Viet Nam recalls the “fragmented authoritarianism” framework developed by Lieberthal and Oksenberg and applied to China (Lieberthal and Oksenberg 1988). In fragmented political structures, agencies advance competing claims to authority over specific policy domains. Competition among agencies create gaps that open space for political bargaining. Policy outcomes reflect compromises reached among agencies following a protracted, incremental decision-making process. Agencies have an incentive to conceal information from each other and form tactical alliances to block the plans of their competitors.

The relevance of the fragmented authoritarianism model to China has been questioned by some, who point to the capacity of the central authorities to enforce their will. Landry argues that China “presents us with a case of an enduring authoritarian regime that has thrived rather than decayed in the era of decentralization (Landry 2011, 15). China has managed to maintain cohesion while also taking advantage of the managerial and administrative benefits of decentralization by controlling the mechanism through which political elites gain access to official positions. Frequent rotation of cadres, especially at the local level, has been carried out to prevent local interests from winning out over the center’s priorities. Edin concurs, focusing on improvements to the central state’s capacity to monitor cadres and reinforce control through rotating more successful local officials among administrative levels and geographic areas. “In sum,” she writes, “the Chinese party-state has the capacity to be selectively effective, that is, to implement its priority policies, and control its key local leaders and strategically important areas (Edin 2003, 52).

In Viet Nam, the central government has not succeeded in using appointments and promotions to enforce discipline and achieve hierarchical coherence within a decentralized system (Jandl 2014, 78). The cadres who rise within the system are not necessarily those who have toed the politburo’s line, but rather political leaders who have managed to build influential political coalitions within the Central Committee and other governing structures. Often this entails implementing policies and programs at the local level that have challenged central directives. Indeed, provincial party cadres play such a large role in the selection of the national political leadership that a case could be that it is the localities that shape the political agenda and not the center.

Nor is rotation of local leaders used as a device to achieve adherence to centrally-determined policies (Vasavakul 2019). In November 2011, for example, only eight provincial party secretaries and two people’s committee chairpersons did not have strong pre-existing ties to the localities in which they were serving. Only ten percent of senior provincial officials were serving in places where they had not spent the bulk of their careers (Pincus et al. 2012, 14). The result of allowing leaders to serve where they have deeply-rooted local loyalties is that there are few checks on the pursuit of local interests. Policy making proceeds through the slow and erratic bargaining processes described in the fragmented authoritarianism framework.

### *The Consequences of Commercialization and Fragmentation*

The effects of fragmentation and state commercialization are evident in every sphere of policy and public administration. Attempts to recentralize decision-making and impose discipline have failed because of the power of state entities to resist coordination and control. The creation in 1994 of “general corporations” modeled on Korea’s *chaebols* and China’s state business groups was intended to reduce fragmentation of SOE management. Conglomerates assembled out of existing state-owned companies were established in sectors ranging from electricity to textile and garment manufacturing. It was thought that rationalization of industry could only proceed if state enterprises were

separated from ministries and provincial governments, since these institutions had a financial incentives to shield SOEs under their control. In a further round of centralization, the government established “economic groups” with ministerial rank to manage the commanding heights of the economy.

The strategy assumed that central authorities had enough power to override local objections to consolidation and rationalization of state firms. That they did not possess this authority is evident from the strategies adopted by state enterprises. Rather than streamline operations and strive for strategic focus, state conglomerates used their privileged access to land and capital to multiply the number of small businesses under their control. Speculative ventures in property and finance made up the bulk of these subsidiaries. Needing the support of local political leaders, state corporation bosses found ways to spread investments over many provinces (Vu 2014, 18). Prior to its collapse in 2010, state shipping conglomerate Vinashin controlled 445 subsidiaries and 20 joint-venture companies including investments in properties, finance, handicrafts, and breweries in addition to ship building. Vinatex, the economic group given responsibility for developing the domestic textile industry, accumulated 120 subsidiaries in property development, banking and finance before it was restructured in 2013 (Pincus 2015).

Management of the equitization process itself has fallen victim to fragmentation and commercialization. The National Steering Committee for Enterprise Reform and Development (NSCERD) was formed in 2000 from the merger of two previous national steering committees to overcome coordination failures. Boards of Enterprise Reform and Development (BERD) were set up in ministries, provincial government, and general corporations, reporting to both NSCERD and their agency heads following the standard model of dual subordination. As they were staffed by ministerial, provincial government and general corporation personnel, the BERDs answered primarily to their local bosses who had an interest in retaining companies under their control (Nguyen Thi Kim Cuc 2010, 136). Despite pressure from the multilateral financial institutions to give NSCERD more powers of enforcement, the institution was confined to a weak, consultative role. As Martin Painter concludes, “in this highly complex and conflict-ridden field of policy, the Committee is generally viewed as a force for prevarication as much as an engine of reform” (Painter 2005).

The response to climate change is another area in which high-level strategies and plans encounter coordination problems and elicit competition among state agencies. The Ministry of Natural Resources and the Environment (MONRE) took the lead role through the National Targeted Program to Respond to Climate Change (2008-2015) and the National Strategy on Climate Change (2011), with the Ministry of Agriculture and Rural Development (MARD), the Ministry of Finance and the Ministry of Planning and Investment (MPI) assigned sector and task-specific responsibilities. The various programs and plans are channeled vertically through provincial authorities to districts and localities with little or no horizontal coordination or consultation. Ambiguous roles and

responsibilities and an absence of coordination and accountability mechanisms results in competition for well-funded initiatives—mainly infrastructure projects—while other dimensions of adaptation are left unaddressed (Phuong, Biesbroek, and Wals 2018, 10).

The absence of medium to large-scale domestic firms in manufacturing, an important drag on productivity growth, is another consequence of fragmentation and commercialization. To take one example, Vietnam's pharmaceutical industry consists of 170 companies, including 20 joint-venture foreign invested firms, with the largest company controlling less than five percent of the market. Until 2009 foreign companies could not establish wholly-owned subsidiaries but this restriction has been removed. The background to this extreme level of fragmentation is the development of state-owned companies in every province to supply generic medicines to local hospitals and clinics. Direct sales to hospitals account for about one third of the market, and pharmacies for the remainder. Although the largest Vietnamese firms have been equitized, they continue to rely on close relationships with distributors and hospitals in their areas. Procurement is carried out by individual hospitals, and the bidding process is notoriously opaque, with high mark-ups for producers financing payments to hospital administrators. Product registration, which is the responsibility of the Drug Administration of Vietnam, is carried out on a case-by-case basis in which the regulator retains considerable discretion. Under these conditions, genuinely private and foreign firms are at a disadvantage in terms of market access, which enables small producers of generics drugs to survive in what on the surface looks like a highly competitive market.

The development of the Ho Chi Minh City port system is another example of institutional fragmentation (Nguyen and Pincus 2011). Ho Chi Minh City and surrounding provinces need a modern port near the main industrial zones and capable of quickly loading container ships. Ho Chi Minh City residents suffer from traffic congestion caused by inner city ports. The relocation of ports would free up valuable riverside property for commercial development. The prime minister approved a master plan in 2005 calling for four ports to relocate to the coastal province of Ba Ria -Vung Tau (*Bà Rịa - Vũng Tàu*) by 2010, and shortly afterwards the Japan Bank for International Cooperation approved a loan of ¥36.4 billion (US\$328.6 million) for the Cai Mep -Thi Vai (*Cái Mép - Thị Vải*) port complex. However, the ports in Ho Chi Minh City are owned and operated by different government agencies and companies. Saigon Port is a subsidiary of Vinalines, the national shipping general corporation. Ben Nghe (*Bến Nghé*) port is operated by a local state-owned company under the People's Committee of HCMC. The Viet Nam International Container Terminal (VICT) is a joint-venture of the state-owned Southern Waterborne Transport Corporation, the NOL Group of Singapore, and Mitsui & Co. of Japan. Saigon New Port (SNP) is owned by the navy. Other small ports are spread across the region. In the end, the central government was unable to implement the master plan because the individual state agencies refused to cooperate. Each agency used the regulatory powers and political influence at its disposal to advance their narrow financial interests.

In 2019, the World Economic Forum ranked Viet Nam 77<sup>th</sup> out of 122 countries in the quality of infrastructure. Viet Nam has invested on average six percent of GDP over the past five years to improve access to and the quality of infrastructure for transportation, communications, energy, urbanization, agriculture, and industry. Although this is a higher proportion of national output than most countries in the region, it will still take many years for Viet Nam to catch up to Malaysia (35<sup>th</sup>), Mexico (54<sup>th</sup>) and even Thailand (70<sup>th</sup>). Additional investment needed for the transition to renewable energy will increase the annual investment requirement to between \$25 and \$30 billion per year until the end of the decade.

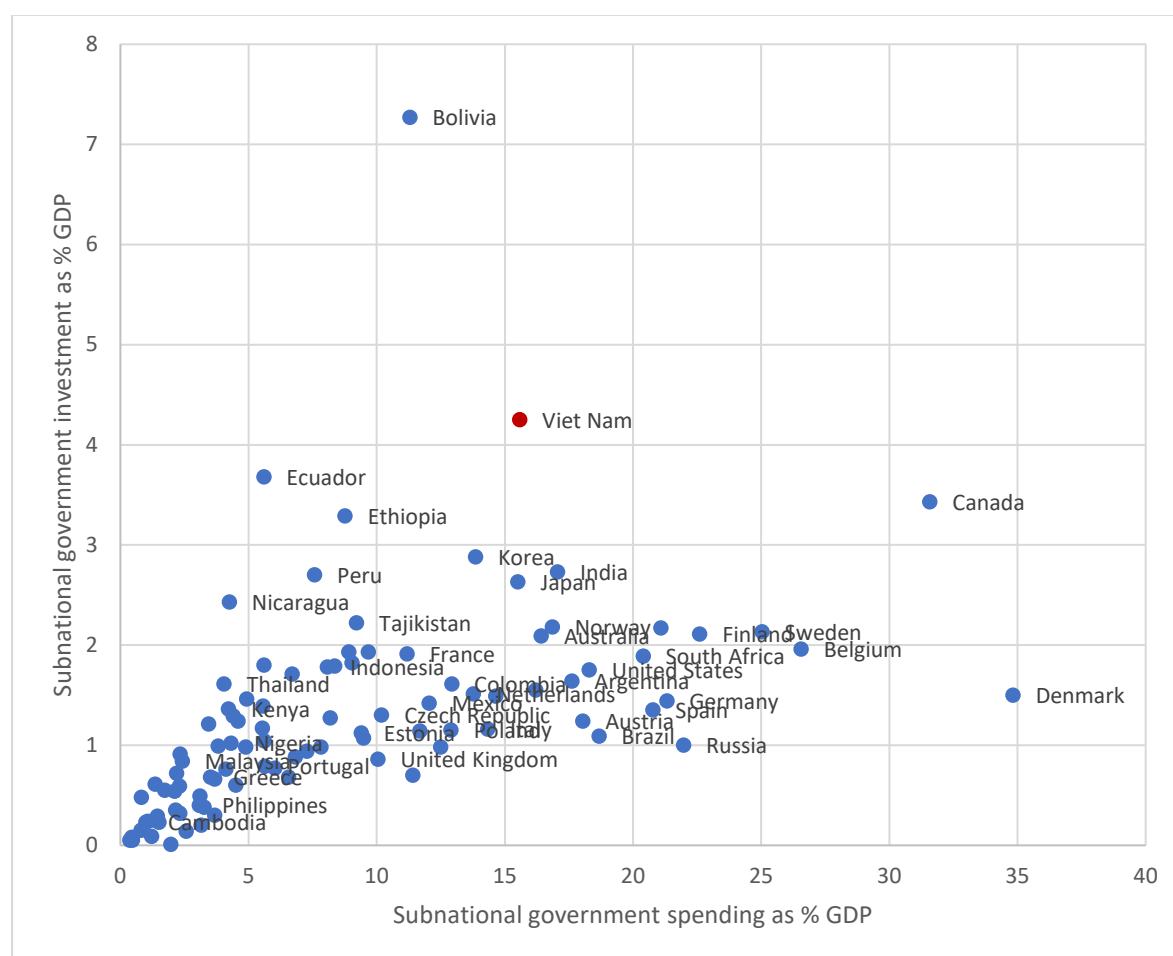
Fragmentation and commercialization are major constraints on public investment. There are too many small projects, planned in isolation from national and regional development plans, managed by local authorities who lack capacity to design, appraise, finance and implement them. The absence of coordination not only causes waste and inefficiency, but also—and more importantly—represents a missed opportunity to align public investment to national priorities such as export promotion, energy transition, investment attraction and job creation. Capital spending is also divorced from recurrent budgets, leading to underspending on operations and maintenance, and rapid deterioration in infrastructure quality.

The public investment management system in Viet Nam is among the most decentralized in the world according to OECD data (Figure 6). While subnational government spending as a share of GDP is higher than average, subnational public investment as a share of GDP is second only to Bolivia. The Planning Law of 2017, which came into force in 2019, calls for strengthening of regional planning mechanisms, but this has not been implemented. The 2019 Public Investment Law, in effect since 2020, introduces additional decentralization measures to speed up disbursement and implementation. Ministries and provinces have been given authority under the law to approve and allocate capital to short- to medium-term (up to five year) projects without central government clearance. The law also created a national information system and database on public investment under the Ministry of Planning and Investment to improve monitoring and evaluation of projects. We do not yet know the extent to which subnational governments and ministries will cooperate with MPI in establishing and populating the database.



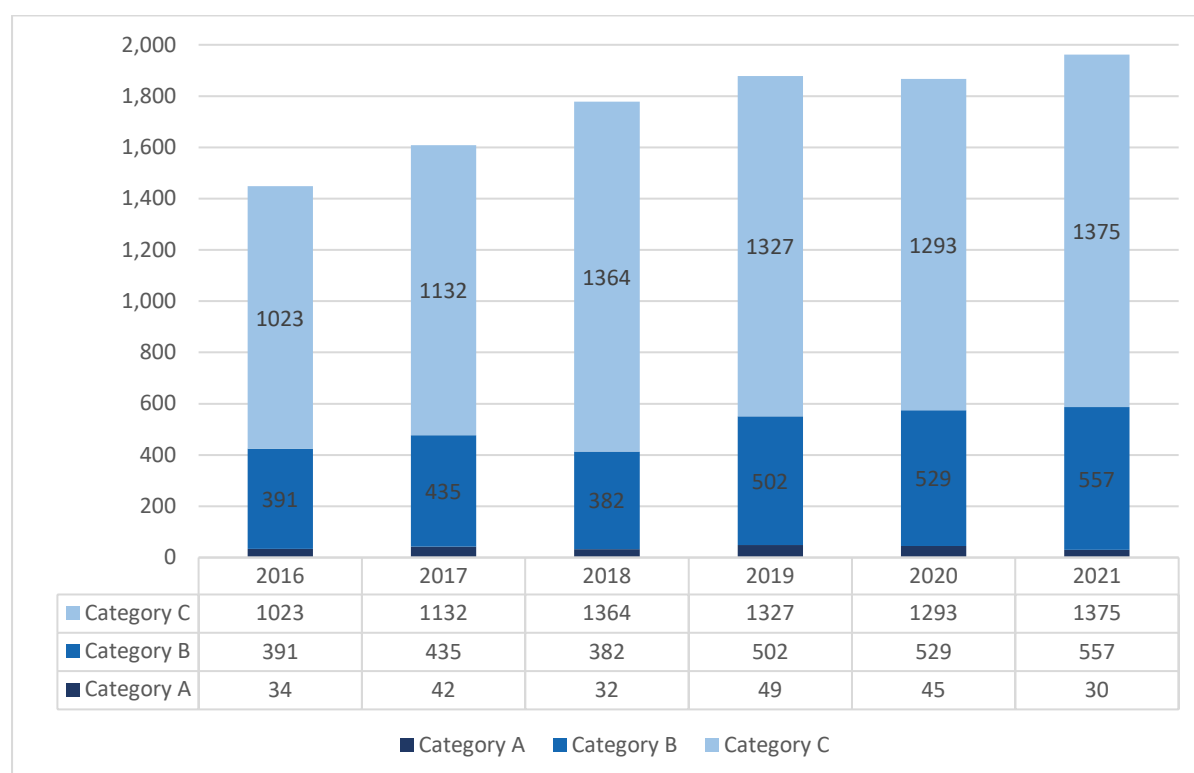
Project delays are endemic, especially for small projects, and the number of overdue projects has increased over time (Figure 7). Investment projects implemented by provincial authorities have also been plagued by cost overruns and violations of administrative procedures. According to the Ministry of Planning and Investment, the main causes are problems with land clearance, late delivery of funds, lack of capacity of investors, project managers and contractors, and complicated investment procedures. Standards of construction have also been found to be inferior, including major landslides caused by hydroelectric projects, collapsed irrigation systems and rapid deterioration of road surfaces. The ministry reports that 1,086 cases relating to violations of public investment rules have gone to trial since 2016.

Figure 6. Subnational government investment and spending as share of GDP, 2017



Source: World Observatory on Subnational Government Finance and Investment (<https://www.compareyourcountry.org/subnational-government-finance-and-investment/en/0//datatable/>)

Figure 7. Delayed public investment projects by category



Source: Ministry of Planning and Investment

Under the Public Investment Law, category A projects are of national significance and approved by the prime minister, while category B and C projects, grouped by the size of investment, are approved by the project promoters.

Decentralization to provinces is not the only cause of fragmented authority. Power is also divided among ministries, other national agencies, and state-owned enterprises. Because of overlapping responsibilities and mandates, agencies at the central, provincial and district levels compete to secure projects advantageous to them. With authority spread across numerous entities at all levels, conflicts often lead to a stalemate as individual agencies have the power to block the plans of competitors even if they cannot push through their own plans. Complex and overlapping rules are subject to multiple interpretations, and long, drawn out negotiations as agencies put forward competing claims to authority and capital.

## Policy implications of State Commercialization and Fragmentation

Fragmentation of authority has deep historical roots in Southeast Asia and is present in every country in the region to some degree. It manifests itself as coordination problems between local and central government, factionalized party politics, a proliferation of state agencies with overlapping mandates, policy gridlock or a combination of the above. Fragmentation issues arise in competitive, multiparty parliamentary democracies and single party systems. Policymaking is weighed down by protracted negotiations among public agencies and the absence of a clear hierarchy of control to reduce the number of players with veto power in the system. Only when faced with external or internal existential threats have political elites been willing to surrender some authority to central authorities to break the policy gridlock.

Game theorists refer to this situation as a commitment problem: elite actors will not commit to rules of the game if they suspect that other elites will violate them even if universal acceptance and application of the rules would leave everyone better off. The instruments available to the central authorities to compel elites to act against their short-term interests for the sake of shared prosperity in the long term are limited. Appeals to civic duty are ineffectual and centralizing decision making in one office or individual can worsen gridlock and decisions are delayed by lobbying and an absence of delegation. Episodes of elite cooperation have generally emerged in response to a serious internal or external threat to the position of elites. In Malaysia, for example, when sectarian violence threatened the viability of the young, multiethnic state in 1969, power was centralized and used to consolidate policy reforms that distributed economic benefits to non-elites (Slater 2010, 23). It is at moments of existential crisis that elites can be persuaded to accept constraints on their behavior in exchange for protection from threats from below or from outside the country.

A unique feature of Viet Nam's institutional development is state commercialization, which is a product of the country's gradual transition from central planning to the market. Especially in the early years, reforms dismantled central planning but had less of an impact on the control of productive assets. Marketization affected two groups: farmers and small traders, who supplied local markets for necessities and traditional services; and state and state-owned institutions that controlled large-scale enterprises, land and finance. Foreign investors added a third group of market participants, first in collaboration with the state and later on their own account. Although equitization restructured SOEs into joint-stock companies, this was not privatization in the normal sense of the term. In the absence of a politically significant group of non-state investors, equitization meant a reconfiguration of state or state-related management of productive assets, not the rise of an independent private sector.

Commercialization compounds the effects of fragmentation to the extent that state agencies seek to expand their authority to realize their commercial ambitions. Provincial governments that cooperate with state or quasi-state property developers are not neutral arbiters when it comes to approving development plans or changing zoning regulations. Ministries and provincial governments that control wholesalers or distributors in strategic sectors are unlikely to favor reforms that increase efficiency and reduce profit margins. The penetration of SOEs and other state entities into the financial sector through ownership of joint-stock commercial is an example of the risks associated with commercialization and fragmentation.

The standard response to governance challenges is to return to basic principles: expand the role of the market mechanism; strengthen property rights; protect the independence of law enforcement and the judiciary; enforce laws against corrupt practices; and increase transparency through reporting requirements and digitalization. In Southeast Asia, progress toward these goals has been uneven because, as noted above, the people charged with enforcing the rules—the economic and political elite—are the very people who benefit from violations of them. Because each society has its own economic structures, history and culture, the resolution of the commitment problem is likely to differ from place to place. There is no common set of institutions or policies that will work everywhere, and any attempt to transplant successful institutional forms without adaptation from one country to another is likely to fail. Decades of public administration reform efforts in Viet Nam based on imported governance models have produced rather limited results (Painter 2003).

China's solution to the fragmentation problem was to decentralize fiscal and administrative authority but retain tight central control over the personnel system. As Landry concludes, "personnel management is the glue that turns the fragments of the Chinese local state into a coherent—albeit colorful—mosaic" (Landry 2011, 79). Frequent rotation of officials and linking of performance against centrally determined benchmarks have acted as commitment devices to align the incentive structures facing local authorities with the aims and objectives of the central government. State agencies are allowed scope for innovation but only within non-negotiable rules of the game. Success indicators are agreed in advance to ensure that political leaders are aware of central priorities, and prospects for promotion are tied to the achievement of these objectives. This form of governance, which Yuen Yuen Ang has termed "directed improvisation," induces competition between state agencies but has managed to avoid zero-sum struggles over resources (Ang 2016; Chen and Naughton 2013).

Power in Viet Nam is more diffuse, and the influence of provincial party chiefs on the selection of the central leadership affords them considerable leverage over central institutions. Local leaders in Viet Nam are rarely rotated away from their home provinces, a practice that reinforces clientelistic relationships between local leaders and state (and quasi-state) business interests. Provincial governments maintain inefficient state-owned manufacturing facilities to retain access to tax revenues, and exchange favors with

state-owned banks and central government planners to finance local projects. Fragmentation results in prolonged bargaining, often leading to stalemates in large-scale public investment projects.

The creation of “capstone agencies,” for example Korea’s Economic Planning Board, has also been suggested as a tool to reduce fragmentation in the public sector. However, this strategy has met with limited success in Southeast Asia. Vietnam’s attempts to establish superordinate central agencies have repeatedly failed, as the example of NCSEDR above has shown. Merging SOEs into large economic groups did not affect their accumulation strategies (Pincus 2016). The creation of new superordinate agencies and conglomerates had no impact on the underlying authority structures, in which veto power is jealously guarded by even small, local agencies. As in India, a country that wrestles with its own problems of state fragmentation, coordinating committees have resulted in deadlock with no agency possessing the authority to override the preferences of others’ decisions (Chibber 2006, 181).

Anti-corruption drives are another instrument that has been used to impose rules on elites. Viet Nam, China, and Indonesia have launched campaigns to increase the perceived costs to political and economic elites of acquiring wealth through illicit means. While these campaigns have uncovered numerous instances of abuse of authority, they have not altered the underlying incentive structures or configurations of power. The response of political leaders has been to reduce their exposure to risk by devising systems with multiple levels of approval for every decision and by shelving controversial decisions whenever possible. In Indonesia, the success of the Corruption Eradication Commission (KPK) in bringing charges against public officials and business elites generated a rare consensus among Indonesia’s fractious political parties: unfortunately, what the parties agreed on was not the elimination of corruption, but legislation to render the KPK harmless by bringing it under the control of the notoriously corrupt police (Mudhoffir 2022).

In the presence of state commercialization, standard governance reforms like privatization and deregulation can lead to unpredictable and even counter-productive outcomes. In Viet Nam, “socialization” of health care and education provision is an attempt to use market signals to increase the supply of essential services and make service providers more responsive to the public. Socialization and private provision of health and education services were introduced in the 1980s to raise funds and reduce pressure on government budgets. Numerous subsidies and exemptions were put in place over the years to provide services to children, the poor and other disadvantaged groups even as responsibility for financing services shifted from the state to households. The government’s goal was to decentralize financing and management while protecting universal access. Financial decisions were devolved to schools and hospitals in 2004, which were permitted them to generate off-budget revenue by delivering private health and education services (London 2018).

The result has been an explosion of commercial services delivered at public facilities that has expanded access to those able to pay but has given rise to perverse incentives. The difference in fees received by hospitals for patients financed by state health insurance compared to private patients encourages hospital managers to shift resources from basic care to for-profit services. Over-prescription of drugs and surgical procedures has emerged as a serious public health problem (UNDP 2011, 97). Primary and secondary schools require students to pay additional fees for a full school day and for extra classes, among other charges (Duong 2015). The commodification of basic services within the state sector is yet another example of state commercialization, or the leveraging of state power to generate profits for government functionaries and their institutions. Much like the equitization process, socialization is marketization without market discipline: state agencies respond with alacrity to market signals, but in the absence of external checks on their behavior they are able to extract monopoly rents from their control over state assets and power.

The most lucrative opportunities for commercialized state agencies come from control over land. Land is owned by the state, with use rights are allocated for agriculture, residential and commercial development, and industry. Citizens and firms can buy, sell and lease land use rights and use them as collateral for loans. Local authorities have the power to convert land from agricultural to industrial or commercial use, and thus at the stroke of a pen increase its value many times over. The land can then be transferred to investors—within or linked to the state—for development. The vast profits generated by the rezoning and selling of land are an important source of revenue for local government but are also a breeding ground for corrupt practices. Disputes relating to ownership of and compensation for land are also the main cause of friction between local governments and the communities that they serve. In 2014, 90 percent of the formal complaints received by government deal with land issues (Wells-Dang, Pham, and Burke 2015, 3).

Much of the problem can be traced back to the discretion that local authorities possess to convert land use rights from agricultural to other uses. The value of the land does not reside in agricultural land itself but rather in the power to rezone it, which effectively reallocates the capital gains from the farmer to the government. Businesses face similar issues, for example when attempting to convert land from industrial to commercial or residential use. While the land has limited market value until the use rights are converted, the potential windfall, and the need to produce use right certificates as collateral for bank loans, are sufficient incentives to hold the land rather than return it to the government. One implication is that SOEs hold back large amounts of land from the market, which has the effect of reducing supply and raising prices. Another consequence is that land redevelopment is held up by prolonged negotiations as companies and government agencies bargain over land use and approvals.

Easy access to credit has also shielded state and state-related companies from competition. State-owned commercial banks (SOCBs) continue to favor SOEs despite the increasing share of the private sector in national income. SOCBs have superior collateral, and in many cases an implicit government guarantee that makes them the safer option for banks. Nor has the rapid growth of joint-stock commercial banks (JSBs) leveled the playing field for private companies. SOEs have acquired stakes in JSBs both to expand into the lucrative financial sector and to channel credit to their own projects (Leung 2009, 48). The government's banking reform strategy relies on equitization of SOCBs, but the governance issues in the JSBs suggest that changes in the structure of shareholdings will not necessarily deliver the expected improvements.

State commercialization has proven difficult to contain because of the relative weakness of elites—both those within and outside of the state—who support or would benefit from clearer boundaries between profit-seeking activity and the other functions of public institutions. An important example is the absence of large, genuinely private exporting companies. Large domestic firms are still overwhelmingly concentrated in property development and finance, activities that strongly favor firms connected to the state. Greater participation of domestic firms in manufactured exports, in the supply chains of FDI exporters, could potentially strengthen the position of non-state actors who have an interest in restraining the commercial behavior of state agencies.

## Conclusion: Taking Institutions Seriously

Viet Nam has achieved remarkable economic success over the past three decades, transforming the country from one of the poorest in Asia to a dynamic, outward-oriented, middle-income country with aspirations to achieve high-income status within a generation. Yet throughout this period of rapid growth and poverty reduction, Viet Nam's economic institutions have never resembled the standard model of governance enshrined in economic development or public administration textbooks.

Institutions do matter, but to understand how they contribute to or constrain growth we need to analyze them within specific social, economic, and political context in which they arise. Understanding their role, and strategies to improve the quality of public institutions, requires patient investigation of their origins, evolution, and the interests that they serve. In concrete situations. Taking institutions seriously means recognizing the limits of what we know and resisting the natural tendency to make broad generalizations based on abstract theories or examples of limited relevance.

Viet Nam will face massive development challenges over the coming decades. Climate change could displace as many of three million people from the Mekong Delta, destroy millions of jobs and reduce the nation's agricultural productivity. Meeting Viet Nam's net zero carbon commitments will require billions in investment in energy, industry, transportation, construction, and agriculture. Geopolitical tensions could result in slower growth of international trade, which would have serious implications for Viet Nam's balance of payments and growth prospects. As incomes rise, foreign companies will move assembly platforms to cheaper countries.

This paper has argued that fragmentation of authority and the commercialization of state institutions are holding back Viet Nam's capacity to respond to these challenges. Fragmentation of public investment has reduced its efficiency and impact, diverting scarce public resources into small and poorly implemented projects while delaying projects of national importance. Addressing the problem is likely to involve establishing a clearer hierarchy of authority, including specific and nonnegotiable targets for sectoral and local authorities linked to national strategies and plans. Breaking the link between land, finance and state commercialization will also be key. Supporting the development genuinely large-scale, private enterprises, especially in export industries, would increase pressure for change.

Such policies would certainly meet with considerable resistance from the state agencies that benefit from commercialization and fragmentation. However, pressure to undertake reforms will almost certainly increase as the negative impact of climate change is felt on the lives of millions of Vietnamese and the costs associated of adaptation and mitigation start to rise. While it is too early to know what form these pressures take, and how the government and other social forces will respond, we can expect the coming years to provide many examples of institutional innovation as localities, regions, industries and sectors confront profound changes in the natural and external environment.



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